



Highlights and Analysis of the Governor's Budget

January 14, 2004
SENATE REPUBLICAN
FISCAL OFFICE



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Budget Briefs

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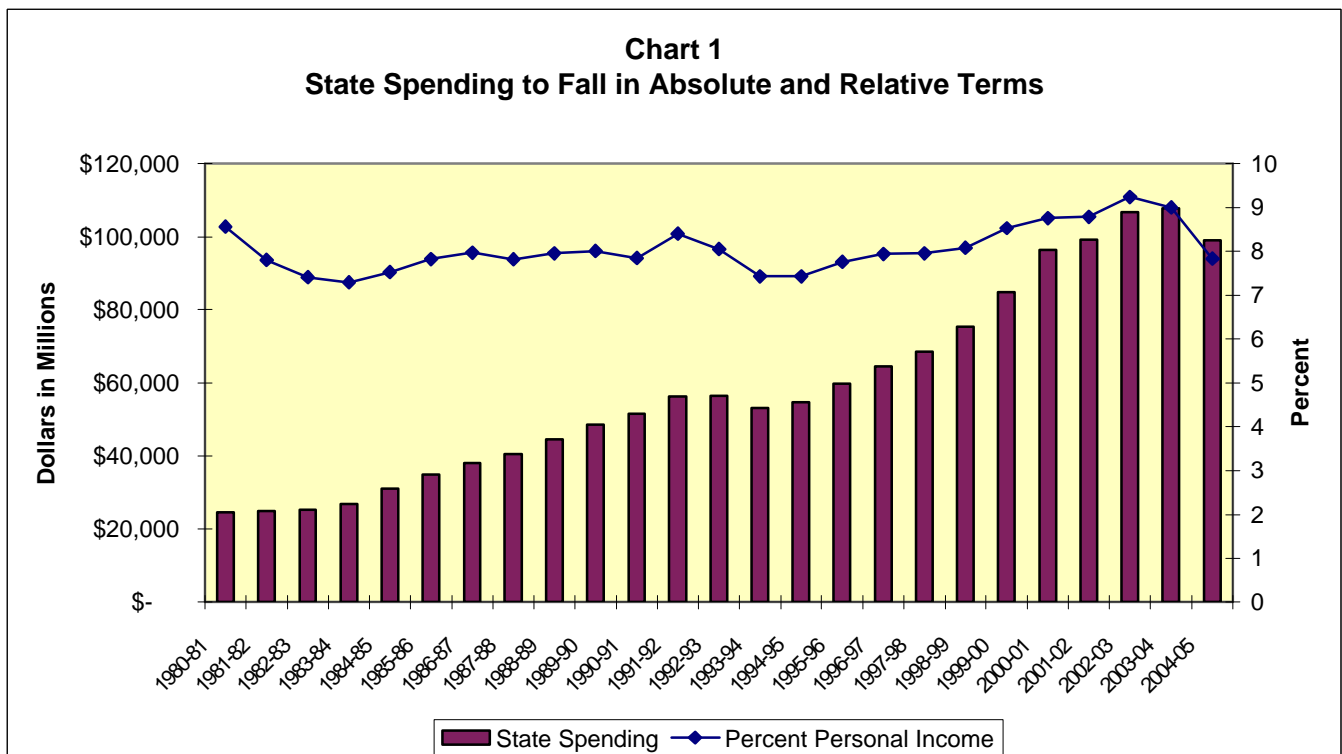
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Overview

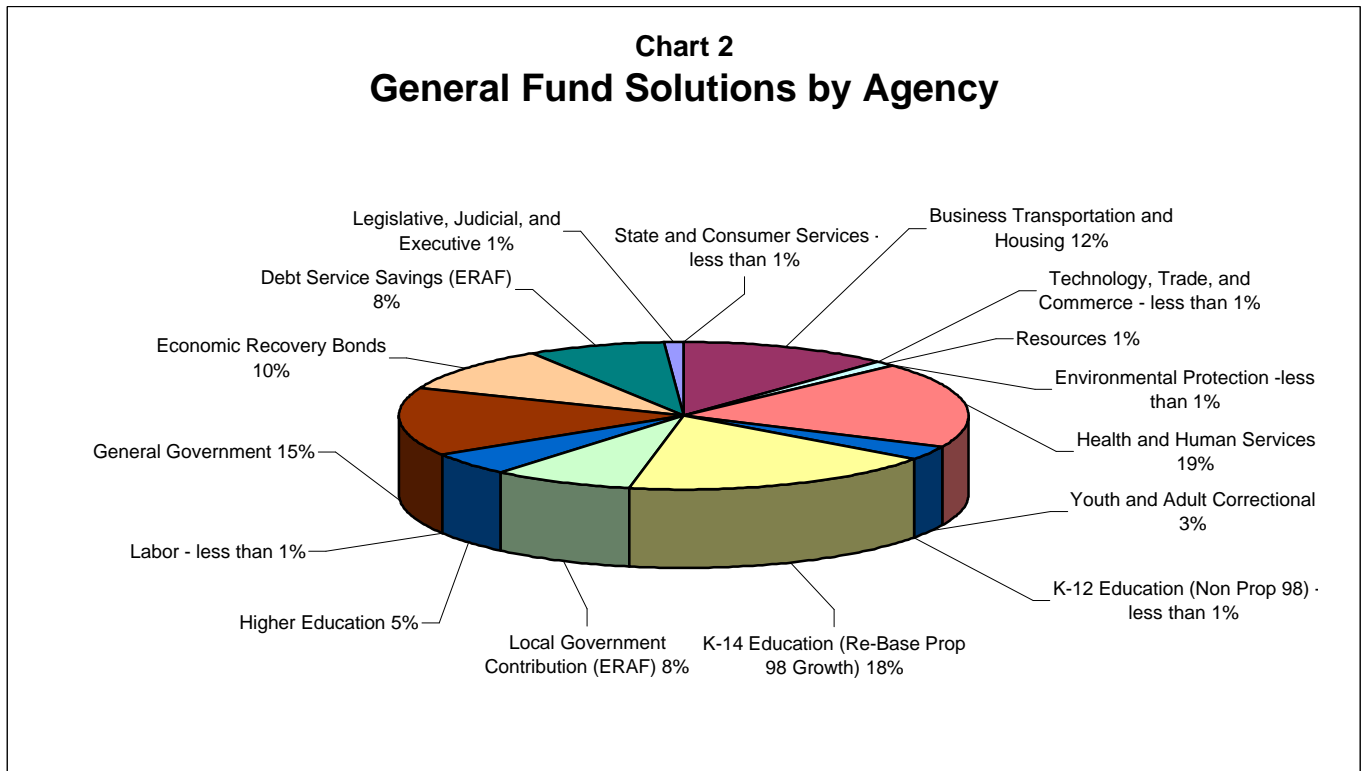
The Governor's Budget for 2004-05 proposes total state spending of \$99.1 billion (\$76.1 billion General Fund). This represents a reduction of \$8.8 billion from projected current-year total spending, and a \$2 billion reduction in General Fund spending. Through a series of spending reductions, cost avoidance measures, economic recovery bonds, and a number of significant reform packages, the Budget addresses a multi-year deficit of \$26 billion. Unlike some of the solutions proposed during previous budget crises, this budget contains no tax increases.

Chart 1 puts the total state spending proposal into historical perspective. Although initial indications last year suggested that spending would decrease in 2003-04, state spending in the current year is forecasted to be \$1 billion higher than in 2002-03. As the chart shows, the 2004-05 Budget proposes spending levels that represent the first significant reduction in absolute terms since the mid-1990s.



The 2004-05 Budget appears to fully address California's budget shortfall. Key points contained or addressed within the Budget include:

The Budget reduces state spending. The Budget contains \$5.9 billion in total spending reductions, and \$3.9 billion in additional cost avoidance. As is indicated in Chart 2, spending reductions and cost avoidance cover a number of state program areas. In some areas the Administration has proposed reductions that will bring state subsidies and benefit levels more in line with those provided by most other states in the nation.



The Budget contains no tax increases. When faced with a similar size budget problem, the previous Administration called for an \$8.3 billion tax increase. In contrast, this year's budget uses a variety of other solutions to bring expenditures in line with revenues. In so doing, the Budget will not risk causing the drag on economic recovery that often accompanies tax increases. The three-year revenue estimates released as part of the Budget project that state revenues will increase by \$4.677 billion, without a tax increase.

The Economic Recovery Bond Act is an integral component of the Budget. The Budget utilizes \$12.3 billion in bond funding as part of the multi-year budget solution. \$9.2 billion of the bond proceeds will be used to pay off the accumulated budget deficit from 2002-03, and \$1.9 billion in bond proceeds will be used to pay for the state cost of employee retirement contributions in 2003-04. Funds from the Economic Recovery Bond Act will also be utilized to establish a new Deficit Recovery Fund. Any bond proceeds received but not needed to address the accumulated budget deficit through 2002-03 will be transferred into this fund, and will be used in 2004-05 to pay for deferred obligations due in 2003-04 and 2004-05. Given the role these funds will play in the Budget, the budgetary consequences for California will be significant if this bond should fail in March.

The Budget calls for significant reforms. The Budget calls for a fundamental review of California government and establishes a California Performance Review to conduct a comprehensive

examination of government services and how they are provided. The Budget also identifies a number of reforms for various programs and services. Significant reforms are proposed:

- Development of multi-tiered benefits and premiums in Medi-Cal
- Capping enrollment and establishing a two-tiered benefit structure in the Healthy Families Program
- Means-tested creation of a co-payment for the use of Regional Center services.
- In an effort to lower costs and increase personal responsibility in child care, the Budget proposes to lower the income threshold for program participation.
- Increase the co-payments associated with child care program participation.
- In increase in employee pension contributions (The budget notes the high cost of benefits packages resulting from existing bargaining agreements.)
- Increased accountability in budgeting for K-12 schools and prisons
- Purchasing and contracting reform in state government.
- Major overhaul of the worker's compensation and unemployment insurance systems

Economic Outlook

National – The Economic Recovery Continues in 2004

The national economy continued to improve in 2003. Real gross domestic product grew by 2.9 percent, up from a 2.2 percent in 2002. During the third quarter of 2003, national economic output reportedly grew by 8.2 percent, the highest rate in nearly 20 years. Personal consumption expenditures were the largest contributors to that growth. However, gross private domestic investment, net export of goods and services, and government spending all also contributed. Gross domestic product is expected to grow by 4.2 percent in 2004. Consumer spending is anticipated to increase by 3.5 to 4 percent, as a result of moderate employment gains and larger than usual tax refunds resulting from the May 2003 federal tax package. Non-farm payroll employment is projected to grow by 150,000 jobs per month in the first two quarters of 2004, before accelerating to about 250,000 per month for the remainder of the year. This historically slower growth rate is primarily due to rapid productivity gains and a more competitive international environment.

Economic profits are forecasted to be strong in 2004, and rising profits and relatively low interest rates are expected to improve the chances of additional stock market gains. Investments in nonresidential structures are also expected to increase, but high vacancy rates for commercial and industrial structures will hamper growth in this area. There is some concern over reportedly limited national energy supplies, and an unusually cold winter or a disturbance in oil output could significantly increase energy costs, potentially dampening economic growth. Nonetheless, it would take a very large spike in energy prices to completely derail the national economic recovery.

California – Continuing to Improve

California's modest rate of growth continued in 2003 and is expected to continue into 2004. Personal income in California increased by an estimated 3.8 percent in 2003, up from 2.2 percent in 2002. It is forecasted to grow by 5.6 percent in 2004. Statewide taxable sales were up year over year, and there were considerable increases in the construction and tourist industries. State exports strengthened in 2003, and the reduction in non-farm payroll jobs slowed in 2003. Low interest rates and federal stimulus are expected to boost the state economy in 2004, and the current economic outlook for California is for moderate growth in 2004 and improved economic growth in 2005. However, job growth in California has continued to be less than the national norm, and improving job growth in the state is important to sustaining the economic recovery. By revisiting and or repealing laws that have increased workers compensation costs and resulted in higher unemployment benefits, the state could increase employment opportunities, improve the business climate in the state, and ultimately result in increased business investment and economic expansion.

State General Fund Revenue Forecast

After several years of soft and declining revenues, state revenue turned the corner in 2003 and improved modestly. Current forecasts call for moderate revenue growth in 2004 and 2005. Estimated revenues for 2002-03 and 2003-04 are up \$1.7 billion. Revenues for 2004-05 are up an additional 4 percent (\$2.9 billion). Revenue increases include gains in the three major state taxes: personal income tax; sales tax; and corporation tax.

General Fund revenues and transfers represent 79 percent of total state revenue. The estimate of General Fund revenue for 2004-05 includes the following main components:

- **Personal Income Tax (PIT).** PIT revenues provide 50 percent of all General Fund revenues, and are forecasted to increase to \$38 billion in 2004-05, up 8.2 percent from \$35.1 billion in 2003-04. Current PIT forecasts assume that the revenue bubble that burst in 2001-02 has completely deflated, and that moderate growth will continue through 2005. Factors contributing to the increase in PIT include greater stock options and capital gains income in particular, which increased 25 percent through the end of 2003, and is projected to increase 10 percent in 2004.
- **Sales & Use Tax (SUT).** SUT revenues provide 33 percent of all General Fund revenues, and are forecasted to increase to \$25 billion in 2004-05, up 5.5 percent from \$23.7 billion in 2003-04. Although SUT receipts are most generally associated with retail spending, approximately one-third of taxable sales are actually attributable to business-to-business transactions. These include purchases of computers, telecommunications equipment, and building materials that go into the construction of new facilities. Resurgence of business investment will play a key role in the growth of this source of state income.
- **Bank and Corporate Tax (BCT).** BCT revenues provide 10 percent of all General Fund revenues, and are forecasted to increase to \$7.6 billion in 2004-05, up 1.9 percent from \$7.46 billion in 2003-04. This estimate reflects the fiscal effects of legislation enacted in 2003, including provisions on abusive tax shelters, and provisions prohibiting banks' use of specific mutual fund structures for tax avoidance purposes. This estimate also includes the sunset of the Manufacturers' Investment Credit (MIC) as of January 1, 2004.

Tax Issues

Reaffirming his commitment to California's taxpayers, the Governor's proposed 2004-05 Budget contains **no new tax increases**. The Budget reflects the realization that California has a spending problem and it sets out to address the spending problem without further burdening the taxpayer.

Tax and revenue issues addressed in the 2004-05 Governor's Budget include:

- **Indian Gaming Revenue - \$500 Million.** In 1999, the state entered into Tribal-State Gaming Compacts with 61 federally-recognized Indian tribes. Additionally, there are a number of "non-compact" tribes that have indicated an interest in negotiating for new gaming compacts. The Governor's Budget projects \$500 million in additional revenue to the state from tribal gaming operations in 2004-05, resulting from negotiations with the tribes. This revenue estimate is one-third the size of the estimate forecasted by the previous Administration and reflects a reasonable estimate of anticipated revenue.
- **Natural Heritage Preservation Tax Credit.** The Budget proposes to suspend the award of credits for two years, 2003-04 and 2004-05, for a General Fund revenue increase of \$8.7 million in 2003-

04 and \$10.3 million in 2004-05. This proposal is contained in the Governor's Mid-Year Spending Reduction Proposal.

- **Fee Increases.** The Budget would reduce General Fund subsidies to a number of programs through the use of \$239 million in fee increases. The is a comparatively modest package of fee increases given the size and scope of the budget deficit and is more than five times smaller than the \$1.259 billion in fee increases proposed by the previous Administration for the 2003-04 budget.
- **Personal Income Tax Integrated Nonfiler Compliance (INC) Program.** The Budget proposes to identify additional taxpayers who do not file tax returns, but owe personal income tax. The program is estimated to increase revenues by \$12 million in 2004-05, and \$43 million in 2005-06.
- **Sales Tax on Gasoline.** The sales tax on gasoline and diesel sales is allocated for transportation purposes. A portion of the sales tax on gasoline and diesel sales is allocated to the Public Transportation Account (PTA). When gasoline prices are high relative to other sales, the PTA receives the "spillover" sales tax revenues. The Budget proposes to maintain the base level of transfers to the PTA, but specifies that any excess sales tax revenue remain in the General Fund. This proposal is estimated to increase General Fund revenues by \$17.5 million in 2003-04 and is part of the Governor's Mid-Year Spending Reduction Proposal.

Reserve For Economic Uncertainty

The Budget assumes an ending reserve for the 2003-04 fiscal year of \$290 million and a year-end reserve of \$635 million for fiscal year 2004-05.

Local Government

The Budget continues to support high-priority programs of mutual concern to both state and local government, such as public safety, health and human services, housing, transportation, and resources. The funding for these programs totals nearly \$6.7 billion. Some of the major programs include:

- \$339 million for State Transportation Improvement Plan (STIP) projects selected by local agencies through their Regional Transportation Improvement Plans.
- \$200 million for the Citizens' Option for Public Safety (COPS) and Juvenile Justice Crime Prevention programs. The COPS program supports front-line local law enforcement , sheriff departments for jail construction, and district attorneys for prosecution.
- \$162.7 million for Alcohol and Drug Programs. This funding supports drug court programs and discretionary regular and perinatal alcohol and drug programs.
- \$149.7 million for 911 Emergency Services. These funds reimburse local dispatch centers for 911 equipment purchases and costs of receiving 911 calls.
- \$72.2 million for Bioterrorism Funding. These funds are provided to first-responder agencies at the local level for anti-bioterrorism activities.

Education Revenue Augmentation Fund Shift. Due to California's current fiscal environment, the Budget includes continuation of the \$1.3 billion vehicle license fee lag reduction initiated in 2003-04, in the form of an increased Educational Revenue Augmentation Fund (ERAF) shift beginning in 2004-05. Under this proposal, local governments would shift approximately \$1.3 billion of property tax revenues to the ERAF in order to reduce the General Fund Proposition 98 obligation.

K-12 Education

Total K-12 funding for 2004-05 is proposed to increase \$1.9 billion above the revised 2003-04 funding level, to \$58.1 billion. This amount is \$2.4 billion over the level provided in the 2003-04 Budget Act.

Proposition 98 Overview. As Table 1 below shows, the Budget proposes Proposition 98 funding for 2004-05 of \$46.7 billion. This funding level for K-12 and community colleges consists of \$29.7 billion General Fund and \$17.0 billion local property tax. The local property tax amount reflects an additional \$1.3 billion in local property tax revenue that is proposed to be shifted from local governments to schools, decreasing Proposition 98 costs to the General Fund. For community colleges, the Budget proposes \$4.7 billion in Proposition 98 funding in 2004-05 – 10 percent of the Proposition 98 split.

Table 1
K-12 and Community College Funding

(Dollars in billions except for per-pupil expenditures)

	2003-04 as Enacted in Budget Act	2003-04 as Proposed in Governor's Budget	2004-05 as Proposed in Governor's Budget
K-12 Total	\$55.7	\$56.2	\$58.1
Prop. 98 Total	\$45.7	\$45.9	\$46.7
Prop. 98 Gen. Fund	(\$31.6)	(\$30.2)	(\$29.7)
K-12 Prop. 98	\$41.3	\$41.5	\$41.9
CCC Prop. 98	\$4.4	\$4.4	\$4.7
Prop. 98 \$ per Pupil	\$6,887	\$6,940	\$6,945
Total \$ per Pupil	\$9,302	\$9,398	\$9,614

Proposition 98 Re-Basing. The \$46.7 billion in Proposition 98 funding for 2004-05, while an increase over the current year, reflects a re-basing of Proposition 98 that provides \$2 billion less than otherwise called for. To understand this, one must recall that in 2001-02, the Proposition 98 formula permitted the Legislature and Governor to appropriate \$3.9 billion less than Proposition 98 requires in a stronger fiscal years. But this reduction was only temporary – Proposition 98 requires the “restoration” of this so-called “maintenance factor” when certain economic indicators improve, as they are projected to do in 2004-05. In fact, were the Proposition 98 formulas strictly adhered to in the budget year, schools would see an increase in funding of an additional \$2 billion in Proposition 98 funding and \$3.9 billion from all sources. Given the continuing challenge of righting the state’s fiscal condition, the Budget proposes to defer the restoration of the maintenance factor, but projects full restoration in four years.

K-12 Per Pupil Funding and Program Adjustments. Total K-12 per pupil funding is proposed to increase \$216 over the revised 2003-04 level and \$312 over the 2003-04 Budget Act, to \$9,614. Of this amount, \$6,945 per pupil is provided through Proposition 98.

For K-12 education, the Budget makes a number of significant budget and policy proposals:

- Shifting \$2 billion from 22 categorical programs into school district and county office of education general purpose revenue-limit funding. School districts would be permitted to allocate their increased revenue limit funding for any purpose – including these categoricals – based on local priorities.

- Providing \$110 million for revenue-limit equalization.
- \$317.2 million to fund enrollment growth in schools in 2004-05, including special education programs, and an additional \$89 million to fund growth in categorical programs.
- Fully funding the statutory COLA increase of 1.84 percent for revenue-limit and categorical funding, at a cost of \$669.8 million.
- \$136 million to fund increased costs to school districts for unemployment insurance (UI), due to a doubling of UI rates.
- Continuing to defer \$1.1 billion in K-12 appropriations initially deferred from 2002-03.
- \$123 million in savings projected from a variety of reforms to child care programs administered by the Department of Education. Among the reforms proposed are:
 1. A reduction in the fee-payment threshold from 50 percent to 40 percent of the state median income;
 2. Elimination of state-subsidized child care for 13 year-olds, as is the policy in all other states; and
 3. Sliding scale child care provider reimbursement rates, based on licensure status and the level of care provided.
- \$37.5 million for growth and COLA in Department of Education child care programs, proposed to funded at \$1.3 billion in the budget year.
- Fully funding deferred maintenance at \$250.3 million, a 225-percent increase over the 2003-04 Budget Act level.
- More than doubling funding for instructional materials by providing a \$185 million increase to help districts purchase standards-aligned textbooks and other materials.
- Saving \$32.6 million by sunsetting, suspending, or eliminating 7 programs, including Local Arts Education Partnership (\$6 million), Healthy Start (\$2 million), and the Charter School Facilities Grant program (\$7.7 million).

California State Library

The Budget proposes no cuts to the Public Library Foundation (PLF) for 2004-05, maintaining the \$15.2 million provided in the current year. The PLF provides funding on a per-capita basis for local libraries.

Higher Education

The Budget proposes base reductions to the University of California (UC) of \$13.8 million and to the California State University (CSU) of \$89.3 million, while the California Community Colleges (CCC) would see a \$506 million augmentation. These figures assume fee increases to obtain General Fund savings, as displayed in Table 2 below. The Budget proposes a new higher education fee policy which would tie fee increases to the cost of living, not to exceed 10 percent per year.

Table 2
Annual Fees and Proposed Increases for Full-Time Resident Undergraduate Students

(Whole dollars, except for last column)

	2003-04	2004-05	Amount of Increase	Percentage Increase	General Fund Savings
Community Colleges ^{1/}	\$540	\$780	\$240	44%	\$91 million
California State University ^{2/}	\$2,046	\$2,251	\$205	10%	\$101.5 million
University of California ^{2/}	\$4,984	\$5,482	\$498	10%	\$195.8 million
^{1/} Thirty-eight percent of community college students receive full fee waivers, and thus pay no fees. ^{2/} For UC and CSU, total General Fund savings also includes fee increases of 20 percent for nonresidents, 40 percent for graduate students, and a reduction in the General Fund subsidy for professional school students.					

University of California

The Budget proposes \$4.5 billion (including \$2.7 billion General Fund) for UC in 2004-05. This represents a net reduction of \$13.8 million (0.3 percent) over the revised current-year funding level, and includes anticipated fee increases. This approach results in \$197.7 million in General Fund savings in 2004-05.

Major savings include:

- \$45.4 million from Academic and Institutional Support.
- \$35.2 million by increasing the student-to-faculty ratio by approximately 5 percent.
- \$33.3 million by eliminating outreach programs.
- \$24.8 million by reducing new freshman enrollment by 10 percent. (These students would be eligible to attend a community college at no cost to the student.)
- \$11.6 million by reducing General Fund support for research by 5 percent.
- \$9.3 million by eliminating the General Fund subsidy for students who exceed by more than 10 percent the units required to obtain their degree (132 semester units or 198 quarter units).
- \$4 million by eliminating General Fund support for the UC Labor "Research" Institutes.

Major augmentations include:

- \$80.5 million to restore one-time unallocated reductions made in 2003-04.
- \$10 million for UC Merced, scheduled to open in 2005-06.

California State University

The Budget proposes \$3.6 billion (including \$2.4 billion General Fund) for the CSU in 2004-05. This represents a net reduction of \$89.3 million (2.4 percent) over the revised current-year funding levels, and includes anticipated fee increases. This approach results in \$212.9 million in General Fund savings in 2004-05.

Major savings include:

- \$52.6 million from Academic and Institutional Support.
- \$53.5 million by increasing the student-faculty ratio by approximately 5 percent.
- \$52 million by eliminating General Fund support for outreach programs.
- \$21 million by reducing new freshman enrollment by 10 percent. (These students would be eligible to attend a community college at no cost to the student.)
- \$24.4 million by eliminating the General Fund subsidy for students who exceed by more than 10 percent the units required to obtain their degree (132 semester units or 198 quarter units).
- \$6 million by deferring 10 percent of the cost of the Common Management System.

Major augmentations include:

- \$69.5 million to restore one-time unallocated reductions made in 2003-04.

California Community Colleges

The Budget includes \$6.9 billion (\$4.7 billion Proposition 98 funds) for community colleges in 2004-05 -- a 7.6-percent increase over the current year -- to serve an estimated 1.137 million full-time equivalent (FTE) students in 2004-05. The enrollment estimate reflects funding for 3-percent growth, and this funding reflects anticipated fee increases.

Major adjustments include:

- \$300.8 million shifted from specified categorical programs (including Partnership for Excellence, matriculation, and part-time faculty programs) to general-purpose apportionments.
- \$125.1 million to fund 3-percent growth (33,000 FTES) in enrollment. This funded growth rate is over one-and-a-half times the growth rate called for in statute.
- \$80 million for equalization to be allocated to community college districts below the 90th percentile of per student funding.

Student Aid Commission. The Budget proposes to increase Cal Grant and other student aid funding to \$684 million in 2004-05, a \$53.8 million-increase over the current year. Student Aid Commission-administered state grants and loans will increase by over 27,000 students in 2004-05, providing more than one-quarter of a million students increased access to higher education.

While increasing the number of awards, the Budget proposes the following savings from student aid programs:

- \$32.7 million by reducing the maximum grant award for new students at private colleges and universities from \$9,708 annually to \$5,482 annually.
- \$23.6 million by removing the automatic link between UC and CSU fee increases and Cal Grant award increases.
- \$11.2 million by reducing the maximum allowable family income for new students from approximately \$66,000 per year to approximately \$59,600 per year (for a family of four).

Health

For the 2004-05 fiscal year, the Budget proposes total expenditures of \$64.8 billion in combined state and federal funds for all Health and Human Services Agency budgets. General Fund expenditures for Health and Human services are projected to be \$24.6 billion, which represents 32.3 percent of the state budget. Even though General Fund expenditures for health and human services in 2004-05 will increase by \$1.8 billion over the 2003-04 expenditure level, the Budget proposes to restructure and reform several key programs in order to generate significant savings in future years.

Medi-Cal

Medi-Cal serves one in five Californians. The Medi-Cal caseload is expected to increase in 2004-05 by 3.3 percent to 6.8 million eligibles, which is consistent with projected population growth. Medi-Cal spending is projected to be \$31.2 billion (\$11.6 billion General Fund), which is 16.2 percent above the 2003 Budget Act. Medi-Cal General Fund expenditures have grown \$3.1 billion (41 percent) since fiscal year 1998-99.

California provides more optional Medi-Cal services than any other large state, but still has one of the lowest average cost-per-recipient rates in the nation – \$4,607 per beneficiary. Currently, Medi-Cal provides more comprehensive benefits than most employer-funded comprehensive health care programs.

In recent years, the Medi-Cal Program has been expanded and has put tremendous fiscal pressure on this state. Expansions include Continuous Eligibility for Children, 1931 (b), Aged and Disabled Federal Poverty Level, and the elimination of the Quarterly Status Report. The General Fund cost of these expansions was \$158 million in the first year of implementation, but General Fund costs are expected to reach \$1.3 billion in fiscal year 2004-05, an 870-percent increase.

There are a number of options for controlling costs in the Medi-Cal Program. The Budget proposes major programmatic reform to align Medi-Cal coverage with private-sector coverage.

- **Structural Reform.** The Governor proposes to restructure the Medi-Cal Program, which will require a federal Medicaid Demonstration Waiver. The Administration's reform proposal will ensure that essential services continue to be provided to California's low-income populations. Specific components of structural reform include the following:
 1. Simplification – Align income standards and asset limitations for the major assistance programs (i.e., Medi-Cal, CalWORKs, SSI/SSP);
 2. Multi-Tiered Benefits/Premiums – Provide comprehensive benefits to federally mandatory populations (children, disabled, and certain long-term care beneficiaries) and provide only basic benefits to optional Medicaid populations unless they pay premiums for more comprehensive services;
 3. Co-Payments – Give providers the legal authority to require the co-payment as a condition of providing non-emergency care;
 4. Conform Benefits to Private Plans – Conform the basic Medi-Cal optional benefit package to that of private health plans; and,
 5. Managed Care – Expand into additional counties and encourage enrollment of the Aged, Blind, and Disabled in managed health care plans.
- **Expanded Anti-Fraud Efforts.** Anti-fraud efforts to date have saved \$371 million General Fund and have avoided General Fund costs of \$352 million. The Budget proposes additional efforts to combat fraud, waste, and abuse in the Medi-Cal Program including:
 1. Enhancing estate recoveries;

2. Increasing long-term care insurance purchases;
3. Expanding hospital billing audits;
4. Sending mid-year billing data to providers with suspicious billing patterns for provider feedback;
5. Confirming receipt of services or products with selected beneficiaries;
6. Restricting electromyography and nerve conduction tests to specially trained physicians;
7. Implementing counterfeit-proof prescription pads; and
8. Reducing the Medi-Cal provider "float" by delaying check-writes by one week.

➤ **Mid-Year Spending Reduction Proposals.** General Fund savings of \$206.9 million and \$479.4 million could be achieved in fiscal years 2003-04 and 2004-05 respectively if the following actions are taken:

1. Eliminate the Wage Adjustment Rate Program that provides supplemental payments to long-term care facilities that have a collectively bargained agreement to increase wages or benefits, for General Fund savings of \$46 million (fiscal year 2003-04 only).
2. Reduce provider rates by an additional 10 percent, for General Fund savings of \$160.9 million in fiscal year 2003-04 and \$462.2 million in fiscal year 2004-05.
3. Cap enrollment for immigrants at the January 1, 2004 level (909,500 beneficiaries), for General Fund savings of \$17.2 million in fiscal year 2004-05.

➤ **Fee Assessment on Managed Care Plans.** The Budget proposes that a six-percent quality improvement fee be assessed on all lines of business within Medi-Cal managed care plans, for General Fund savings of \$75 million in fiscal year 2004-05. Plans would be required to break off the Medi-Cal portion of their business into a separate entity as a condition of federal approval, and the federal government has stipulated that the fee would have to be assessed on all lines of business, not just the Medi-Cal line of business.

➤ **Adult Day Health Care (ADHC) Reform.** The Budget proposes a one-year moratorium on new ADHCs and a moratorium on certification for increased capacity of existing centers, for General Fund savings of \$25.4 million (\$12.7 million General Fund) in fiscal year 2004-05. In addition, Therapy and Transportation services would be removed from the "bundled" reimbursement rate and could be billed for separately by ADHCs.

➤ **Revised Rate for Federally Qualified Health Centers (FQHCs) and Rural Health Clinics.** The Budget proposes to seek federal authority to eliminate the alternative rate methodology that allows the use of unaudited cost reports from the year 2000, and to recalculate and set rates prospectively using the average of 1999 and 2000 cost reports. New rates would be based on audited or reconciled cost information, for savings of \$7.6 million (\$3.8 million General Fund) in fiscal year 2003-04 and \$64.5 million (\$32.2 million General Fund) in fiscal year 2004-05.

➤ **Cost Control for County Administration of the Medi-Cal Program.** The Budget proposes that the Department of Health Services submit a control plan to county welfare departments in January 2005 that includes productivity standards and overall performance standards because counties currently have no incentives to control Medi-Cal costs. The Budget also proposes that statutory language be adopted to restrict county wage increases to specified cost-of-living adjustments.

Public Health. Expenditures for all public health programs and state support are projected to be \$3 billion (\$631.6 million General Fund) in 2004-05. This represents a General Fund reduction of \$55.6 million (8.1 percent) in current-year expenditures. The Administration proposes to reform and restructure a variety of public health programs.

➤ **Children's Medical Services (CMS).** The Budget proposes a total of \$198.6 million (\$135.8 million General Fund) in local assistance funding for CMS programs, which is a decrease of \$40.7 million

(\$43 million General Fund) below the 2003 Budget Act. General Fund costs increased nearly \$84.7 million (82 percent) between fiscal year 1998-99 and the current year. CMS includes three major programs: California Children's Services (CCS), Genetically Handicapped Persons Program (GHPP), and Child Health and Disability Prevention (CHDP). Although there is no legal entitlement to these services, these programs have historically received full funding for all caseload growth. In order to help contain the costs of these programs, the Budget proposes the following changes:

1. Enrollment in CCS and GHPP will be capped, as proposed in the Mid-Year Spending Reduction Proposal. Waiting lists will be established, and clients will be served on a first-applied, first-served basis.
2. Co-payments will be charged for GHPP services, which will generate \$576,000 in General Fund savings in fiscal year 2004-05.

➤ **HIV/AIDS Treatment and Prevention.** The Budget proposes \$323.4 million (\$127.3 million General Fund) for the Office of AIDS' Treatment and Prevention program. This is a decrease of \$6.6 million, or 2 percent, below the 2003 Budget Act. Costs have increased nearly \$33.7 million, or 35 percent, between 1998-99 and the current year. Almost half of total HIV/AIDS program expenditures (\$207.3 million) are budgeted for the AIDS Drug Assistance Program (ADAP). The Administration proposes to cap ADAP enrollment, consistent with its Mid-Year Spending Reduction Proposal. Waiting lists will be established, and clients will be served on a first-applied, first-served basis. It is estimated that ADAP will serve 26,500 clients in fiscal year 2004-05.

➤ **Proposition 99 Expenditures.** The Budget projects that total resources available for fiscal year 2004-05 will be \$36.5 million below the 2003 Budget Act. Due to lower revenues, funding for health programs will decline by an average of 15.5 percent. Reductions are proposed in the following areas:

1. Health Education programs – \$8 million
2. University of California research – \$7.4 million
3. Breast Cancer Early Detection Program – \$6.1 million
4. California Healthcare for Indigents Program – \$4.2 million
5. Department of Education – \$3.6 million
6. Various resources departments – \$2.2 million
7. Rural Health Grants – \$1 million

Healthy Families Program. Expenditures for the Healthy Families Program (HFP) have grown from \$59.3 million (\$15.6 million General Fund) in fiscal year 1998-99 to a proposed \$839.1 million (\$305.5 million General Fund) for fiscal year 2004-05, which is a General Fund increase of 1,858 percent. The Budget projects that the HFP caseload could climb to 737,000 children. The Administration proposes to control future program expenditures by capping enrollment in the near-term and providing higher-income program subscribers with a choice of benefit packages in the long-term. Capping enrollment will save \$86.3 million (\$31.5 million General Fund) in fiscal year 2004-05. A two-tiered benefit structure would be implemented in fiscal year 2005-06 for children in families with income between 201-250 percent of the federal poverty level. A basic benefit package (excluding vision and dental services) would be offered at current premium levels, and a comprehensive package would include all benefits with higher monthly premiums.

Mental Health. The Budget includes \$2.5 billion (\$910.7 million General Fund) for state hospitals and community mental health programs, which is a net increase of \$373.4 million (\$39 million General Fund) above the 2003 Budget Act.

➤ **State Hospitals.** General Fund expenditures have increased by \$215.6 million (76 percent) between fiscal year 1998-99 and the 2003 Budget Act. In fiscal year 2002-03, it cost \$141,000 per patient per year to serve individuals in state mental hospitals. The Budget proposes reforms that

will achieve savings and cost avoidance of \$17.2 million General Fund in fiscal year 2004-05 and \$25.6 million in fiscal year 2005-06:

1. Sexually Violent Predators (SVPs) will be given indeterminate commitments, thus eliminating the need for unnecessary evaluations scheduled at regular, two-year intervals.
2. SVP treatment and supervision services will be restructured so that hospital staffing can be adjusted according to the number of patients who participate in treatment.
3. SVP commitment trials are encouraged to be conducted prior to the inmate's release from prison, and SVPs should be kept in local custody while awaiting a commitment hearing.
4. Intake for judicially committed patients should be prioritized and limited to those most in need of services.

➤ **Early Periodic Screening, Diagnosis, and Treatment (EPSDT).** The Budget proposes \$787 million (\$365 million General Fund) to maintain EPSDT services. Not including the accrual-to-cash accounting change, EPSDT costs have increased 285 percent between fiscal year 1998-99 and the 2003 Budget Act. The Budget proposes several measures to maintain services while bringing costs under control:

1. Maximum rates paid for services should be updated by surveying actual costs, an effort which is estimated to save \$40 million General Fund.
2. The Department of Mental Health should conduct targeted audits of claims to curtail fraud, waste, and abuse, which should save a minimum of \$5.7 million General Fund.
3. California should pursue federal authority to narrow the very broad medical necessity criteria, which could result in significant General Fund savings starting in fiscal year 2005-06.
4. The Children's System of Care Program can be discontinued because EPSDT serves a large number of needy children and young adults, and a wide range of medically necessary services is available.

➤ **Community Mental Health Services.** The Budget includes \$1.8 billion (\$298.6 million General Fund) for community mental health services. This is a net increase of \$304.2 million compared to the 2003 Budget Act. General Fund expenditures for these programs grew more than \$90 million (39 percent) between fiscal year 1998-99 and the current year. Services are delivered through several key programs:

1. The Integrated Services for Homeless Adults Program will receive continued funding of \$54.9 million General Fund, which will provide essential fiscal relief to counties.
2. The Budget proposes an increase of \$10 million (\$5.1 million General Fund) for increased caseload in the Managed Care Program, which allows counties to manage treatment services at the local level.
3. The Budget proposes an increase of \$1.9 million (\$470,000 General Fund) to expand the Preadmission Screening and Residential Review Program, which evaluates individuals admitted to nursing homes to determine if community treatment alternatives are available.

Developmental Disabilities. In the last five years, General Fund expenditures through the Department of Developmental Services grew more than \$1.1 billion. Funds are used to provide services to approximately 200,000 persons in the community through the Regional Center system and to about 3,500 individuals who reside in state Developmental Centers. The Budget proposes a number of reforms to control costs while maintaining the Lanterman Act entitlement.

➤ **Regional Centers.** The Budget proposes \$2.7 billion (\$1.8 billion General Fund) to support the Regional Centers in fiscal year 2004-05. This includes an increase of \$27.8 million (\$3.1 million General Fund) over the revised current-year estimates. Since fiscal year 1998-99, the program has grown by \$1.1 billion General Fund, or 166 percent. The Budget does not cap caseload or eliminate services. The Budget does, however, reform the service delivery system and makes significant adjustments to Regional Center costs:

1. Those who can afford it will be assessed a co-payment for services.
2. Services will be required to be delivered in the most cost-effective manner.
3. Meaningful statewide standards will be established that will be used as the basis for setting standard rates for all services.
4. Regional Centers will receive an unallocated reduction of \$6.5 million General Fund to control administration costs.
5. A shift of Title XX Grant funding to the Regional Centers will save \$48 million General Fund.

- **Developmental Centers.** The Budget proposes \$690.1 million (\$370.3 million General Fund) to operate the Developmental Centers. General Fund expenditures have increased \$121.9 million (49 percent) between fiscal year 1998-99 and the 2003 Budget Act. The average cost per resident rose from \$124,000 in fiscal year 1998-99 to a projected \$205,000 in fiscal year 2004-05. The Administration will be considering potential closures of Developmental Centers and the placement of residents in less restrictive community-based settings. In the interim, the Budget suggests that food services could be provided through contract, which would be more cost-effective.

Human Services

Child Support Services. The Budget proposes \$1.3 billion (\$499 million General Fund) for child support services. Expenditures increased by \$605.1 million (\$247.8 million General Fund), or 105 percent, from 1998-99 to the 2003 Budget Act.

- **Automated System Penalties.** The Budget proposes \$195 million General Fund in 2003-04 and \$220 million General Fund in 2004-05 to pay federal penalties because the state failed to implement a single, statewide automated child support system. The \$220 million penalty reflects an \$11.4 million-increase over the amount appropriated in the 2003 Budget Act. The Budget proposes to make permanent a requirement included with the 2003 Budget Act that counties pay 25 percent of the annual penalty. This county share of costs would generate 2004-05 savings of \$55 million General Fund. The state expects to have the new California Child Support Automation System complete by 2008-09. However, the Administration expects to begin negotiations with the federal government in the near future regarding relief from this penalty.
- **County Administration.** Although the Budget proposes to reduce the amount counties receive via the statutory formula, the Budget provides \$193.3 million, or generally the same level of funding for local programs expenditures that was provided in 2003-04. As the state and federal government provide the funding to support collection efforts, the Budget also proposes that the county share of child support collections be eliminated. This proposal would result in additional General Fund revenues of \$39.4 million in 2004-05.

Welfare-to-Work. The Budget provides \$6.4 billion for California Work Opportunity and Responsibility to Kids (CalWORKs) programs, including \$4.7 billion for direct programs, \$1.5 billion for other programs, and \$158.4 million for a reserve to mitigate the potential for additional federal requirements and penalties. The funding consists of \$3.6 billion in federal funds from the federal Temporary Assistance to Needy Families (TANF) grant, \$2.6 billion state General Fund, \$148.4 million from county sources, \$95 million federal TANF funds available from previous years, and \$54.4 million in Employment Training Panel funds.

The Budget indicates that caseload growth is continuing to flatten after many consecutive years of decline. Estimated CalWORKs caseload for 2004-05 is 481,000 cases, an increase of 2,000 from 2003-04.

- **Encourage Work Participation.** The Budget includes an augmentation of \$47.2 million for the current year to fully fund projected caseload utilizing employment services. In addition, the Budget proposes reforms designed to encourage individuals to seek work and remain on program assistance on a temporary basis. These reforms include: (1) requiring work participation of at least 20 hours per week within 60 days of the receipt of aid; (2) reducing child-only grants by 25 percent for adults that fail to meet work participation requirements within one month of being sanctioned; and, (3) reducing child-only grants by 25 percent for individuals who have received aid for more than 60 months. These proposals will save \$26.4 million in 2004-05.
- **Prioritize Funding.** The Budget proposes to prioritize available funding for employment and other core services. The Governor's Mid-Year Spending Reduction Proposal assumed a 5-percent reduction to CalWORKs grants for savings of \$45.3 million in the current year and \$179.7 million in the budget year, to bring California's spending in line with other large states. The Budget proposes to suspend the CalWORKs Grant COLA in 2004-05. In addition, the Budget proposes to reduce \$134.3 million in funding for at-risk youth, \$30.5 million for tribal programs to reflect declining tribal caseload, and \$6.2 million for miscellaneous discretionary programs.

Supplemental Security Income/State Supplementary Payment (SSI/SSP). The Budget proposes \$3.3 billion for SSI/SSP in 2004-05, a one-percent decrease from the 2003 Budget Act. The Budget estimates 1.2 million cases in 2003-04, an increase of 2.1 percent over 2002-03. The caseload consists of 68 percent disabled, 30 percent aged, and 2 percent blind persons. The General Fund expenditures in the SSI/SSP program grew by \$1.1 billion, or 51 percent, from 1998-99 to the 2003 Budget Act.

- **Maintain Existing Grant Levels.** The Budget proposes to suspend the January state COLA of 2.8 percent for SSI/SSP grants and withhold the January 2005 federal COLA of 1.8 percent, for General Fund savings of \$134.7 million in 2004-05 and \$269.4 million annually thereafter. However, it is important to note that overall grant payment standards increased on January 1, 2004 to \$790 for an individual and \$1,399 for a couple, based on a 2.1-percent federal COLA passed through in the current year. As shown in Table 3 below, California provided the highest level of cash grants to SSI/SSP recipients among the ten most populous states in 2003.

Table 3

Comparison of the 2003 SSI/SSP Maximum Payments for the Ten Most-Populous States				
State	Aged and Disabled		Blind	
	Individual	Couples	Individuals	Couples
California	\$778	\$1,382	\$842	\$1,602
New York	639	933	639	933
New Jersey	583	854	583	854
Pennsylvania	579	873	579	873
Michigan	566	850	566	850
Florida	552	829	552	829
Georgia	552	829	552	829
Texas	552	829	552	829
Illinois	552	829	552	829
Ohio	552	829	552	829

In-Home Supportive Services (IHSS). The Budget proposes \$899.4 million General Fund for the IHSS program in 2004-05, a decrease of 29.4 percent from the 2003 Budget Act. The caseload is estimated to be 302,000 recipients in 2004-05. General Fund expenditures in the IHSS program grew by \$743.3 million, or 140 percent, from 1998-99 to the 2003 Budget Act.

- **Fraud, Waste, and Abuse.** The Budget proposes to submit a proposal in the 2004 May Revision to improve IHSS needs assessments and reduce over-authorization of service hours. According to the Administration, up to 25 percent of all paid services under the IHSS program may be unnecessary or not actually provided.
- **Reduce State Funding for Wages and Benefits.** The Budget includes General Fund savings of \$98 million in 2004-05 and \$130.7 million annually thereafter for a proposal to reduce the state share-of-cost of provider wages and benefits and contract provider rates to the state minimum wage. Currently, the state shares up to \$10.10 per hour in provider wages and benefits, and up to the Maximum Allowable Contract Rate for contract providers.
- **Relieve Local Requirements.** The Budget proposes to make optional the Employer-of-Record (EOR) and Advisory Committee requirements. Currently, counties are required to establish an EOR to serve as the employer of IHSS providers for collective bargaining purposes. In addition, counties are required to establish an advisory council to provide recommendations on administration of the IHSS program. These proposals would result in savings of \$2.2 million in 2004-05 and \$2.9 million annually thereafter.
- **Program Reform.** The Budget proposes to eliminate certain domestic services for recipients who live with their family members, when the need for these services is provided in common with other household members. Services affected by the proposal would include housekeeping, meal preparation and clean-up, laundry, food, shopping, and errands. This proposal would result in General Fund savings of \$26.3 million in 2004-05 and \$35.1 million annually thereafter. In addition, the Administration proposed in November 2003 to eliminate the state-only Residual Program, which provides payments to parent and spouse caregivers. This proposal results in General Fund savings of \$88.8 million in 2003-04 and \$365.8 million in 2004-05 and annually thereafter.

Foster Care. The Budget provides \$1.1 billion (\$470.1 million General Fund) for foster care grants and administration. General Fund costs for this program have grown by \$95.7 million, or 23 percent from 1998-99 to the 2003 Budget Act. However, caseload declined by 9 percent during the same time period.

- **Program Reform.** The Budget proposes to: (1) establish performance-based contracts for higher cost providers, such as Foster Family Agencies and Group Homes; (2) restructure foster care rates to encourage placements in less-restrictive, less-costly settings; and, (3) pursue a federal waiver to apply federal foster care funds for other purposes, including prevention of child abuse and reducing out-of-home placements. Although the specifics of the proposals will be outlined in the 2004 May Revision, these proposals are intended to promote the care of more children in a family-home environment and save \$20 million General Fund in 2004-05. Additional savings are anticipated in future years.

Community Care Licensing. The Budget includes \$124.9 million (\$42.2 million General Fund) for licensing facilities that serve 1.4 million clients. The funding level reflects an \$11 million (\$7 million General Fund)-increase from the 2003 Budget Act.

- **Fee Increase.** The Budget increases fees for licensed facilities to generate an estimated \$5.8 million in additional General Fund revenues in 2004-05. The proposal would increase fees for child day care, children's residential, adult care, and senior care facilities annually in approximately equal increments over a three-year period, until General Fund is no longer needed to subsidize the licensing program.

Immigrant Programs. The state provides health and human services to approximately 44,000 immigrants at a total annual cost of over \$176.6 million. State expenditures for immigrant services have increased by 99 percent from 1998-99 to the 2003 Budget Act, while caseload has decreased by 48 percent during the same time period.

- **Improving Accountability and Service Delivery.** The Budget includes savings of \$6.6 million by restructuring and consolidating certain programs that provide services to immigrants and funding them in a single block grant to counties. Under the proposal, counties would have greater discretion in meeting local safety-net service needs of their documented immigrant population. The Administration will develop further details of the proposal in the 2004 May Revision. Programs included in this proposal include CalWORKs, the California Food Assistance Program, the Cash Assistance Program for Immigrants, and Healthy Families.
- **Cap Enrollment** – The Budget also includes \$25 million General Fund savings in 2004-05 for the proposal introduced in November 2003 to cap enrollment of discretionary state-funded health and human service programs for immigrants. In addition to the above programs, the proposal included Medi-Cal non-emergency services for documented and undocumented immigrants.

Transportation

Proposition 42. Enacted by the voters in the March 2002 election, Proposition 42 amended the State Constitution to permanently dedicate sales taxes on gasoline for transportation projects. Specifically, the Proposition requires the transfer of gasoline sales tax revenues from the General Fund to a newly created Transportation Investment Fund (TIF). The Proposition also allows the Administration and the Legislature (if two-thirds of the membership approve) to suspend the transfer of sales tax revenues in a fiscal year in which the transfer will result in a significant negative impact on government functions funded by the General Fund.

The Budget enacted in August of 2003 partially suspended the Proposition 42 transfer. Of the total \$1.145 billion in gasoline sales tax revenues, \$856 million was to be suspended with \$289 million to be transferred to the TIF and allocated to the Traffic Congestion Relief Program (\$189 million) and the State Transportation Improvement Plan (\$100 million). However, in his Mid-Year Spending Reduction Proposal for 2003-04, the Governor proposes to repeal the statutory authority for the Traffic Congestion Relief Program (TCRP) and to transfer \$189 million back to the General Fund. This proposal would increase General Fund resources by \$189 million and eliminate the special carve-out for the pet transportation projects of former Governor Davis. (See discussion under “Repeal of the Traffic Congestion Relief Program”). The Legislature has not yet taken action on the Governor’s mid-year reduction proposals.

For the 2004-05 fiscal year, the Budget proposes to suspend the Proposition 42 transfer, an action the Administration indicates it was forced to take given the ongoing fiscal crisis. This proposal would reduce General Fund expenditures by \$1.127 billion. At the same time, the Budget proposes to appropriate \$800 million in GARVEE bonds to continue transportation improvements. (See discussion under “GARVEE Bonds” below).

GARVEE Bonds. Grant Anticipation Revenue Vehicles (GARVEE Bonds) are debt instruments where future federal highway funds are pledged to meet debt service requirements. The Budget proposes to appropriate \$800 million in 2004-05 from GARVEE bond proceeds for highway and road construction and improvements. Although this approach is more costly than pay-as-you-go, it infuses funds into transportation and allows projects to continue. Absent funding, projects could come to a halt in the near future, resulting in costly contract termination penalties and potentially significant job loss. Employment statisticians estimate that, for every \$1 billion spent on transportation, approximately

26,000 jobs are created. The Budget also proposes to appropriate \$804.4 million for payment of principal and interest on GARVEE bonds already approved by the California Transportation Commission and to be issued in February 2004.

Repeal of the Traffic Congestion Relief Program. Enacted in 2000, the Traffic Congestion Relief Program (TCRP) was a carve-out for the pet transportation projects of former Governor Davis. Unlike projects in the State Transportation Improvement Plan (STIP), where projects are prioritized by regional planning agencies selected by the non-partisan California Transportation Commission, the 141 projects in the TCRP were hand-picked by the Davis administration and by-passed the normal competitive funding selection process. Furthermore, over 60 percent of the funding (which is derived from sales taxes on gasoline) would be used to fund non-highway projects such as rail and transit.

In his mid-year reduction proposal for 2003-04, the Governor proposes to repeal the TCRP, but allows these projects to be funded through the STIP or other funding sources if local transportation agencies deem them a high priority. To the extent this occurs, other STIP projects could be delayed or eliminated altogether.

Repeal of High-speed Rail Bond. Chapter 697, Statutes of 2002 (SB 1856 – Costa) authorized a \$9.95 billion bond measure on the 2004 ballot to fund the planning and construction of a high-speed passenger rail system. Given the state's fiscal condition and the impact a debt service of that magnitude would have on the General Fund, the Budget proposes to repeal Chapter 697/02 and remove the High-speed Rail General Obligation Bond from the 2004 ballot. The Administration indicates that the needs for funding a high-speed rail will be assessed as part of an overall discussion of transportation resources.

Aeronautics Account Transfer to the General Fund. Revenues for the Account are derived from an excise tax on aviation and jet fuel. These funds are typically used by publicly-owned airports to maintain and improve runways. In 2002 and 2003, approximately \$6 million and \$4.8 million, respectively, were transferred from the Aeronautics Account to the General Fund. The Budget proposes to transfer \$745,000 in 2004-05.

Staffing Reductions at Caltrans. The Budget proposes 21,570 positions for Caltrans in 2004-05. This represents a reduction of 7 percent, or 1,601 positions, from the 23,171 positions authorized in the current year pursuant to the Budget Act of 2003. Of the total positions eliminated, almost 1,200 positions are attributable to the personnel adjustments required in Control Section 4.10 of the 2003 Budget Act, and the remainder are related to repeal of the TCRP and expiring limited-term positions.

Federal Reimbursements. As part of his Mid-Year Spending Reduction Proposal, the Governor proposes to alter cash management procedures in order to recoup \$800 million in federal reimbursements. These funds would be used for loans/transfers and to relieve the General Fund as follows:

- \$406 million to repay the General Fund for debt service on transportation bonds;
- \$200 million to be loaned to the General Fund; and
- \$108 million in property sales and rental income to be transferred to the General Fund each year for two years.

Public Safety and Judiciary

Judiciary

The 2004-05 Budget for the Judiciary (Supreme Court, Court of Appeals, Judicial Council/Administrative Office of the Courts, and the Habeas Corpus Resource Center) totals \$373.8 million, which includes \$312.8 million in state operations and \$61 million in local assistance. The Budget includes the following adjustments:

- An augmentation of \$235,000 from the Court Interpreter Fund to fund the increased cost of court interpreter certification activities.
- An ongoing unallocated General Fund reduction of \$9.8 million in 2004-05.

Trial Courts. The Budget proposes \$2.2 billion (\$1.1 billion General Fund and \$1.1 billion in various special funds) for State Trial Courts in 2004-05, reflecting an overall decrease of approximately \$37.3 million, and a General Fund increase of \$64 million over the revised current year. The Budget includes the following adjustments:

- An unallocated General Fund reduction of \$59 million. However, the Trial Court budget will see a General Fund net increase of \$64 million in 2004-05, due to the restoration of various one-time reductions taken in 2003-04. The Administration indicates it will support efforts by the courts to restructure operations and improve accountability that would allow courts to achieve efficiencies and savings in order to operate within the proposed budget. Allowing the state to participate in the collective bargaining process, and restructuring the method by which court security is provided are two examples of potential ways to improve accountability and service delivery.
- A General Fund increase of \$2.6 million in order to comply with a statutory requirement to reimburse trial courts for costs related to hearings or trials for crimes committed in a state prison. The Budget proposes a similar reduction to the California Department of Corrections' budget.

Additionally, the Budget proposes a loan to the General Fund of \$30 million from the State Court Facilities Construction Fund. According to the Administration, this loan would not impede the fiscal efforts to transfer court facilities from the counties to the state in 2004-05 pursuant to Chapter 1082, Statutes of 2002.

California Highway Patrol (CHP). The CHP is the state's largest law enforcement agency, patrolling over 105,000 miles of state highways and county roads to ensure the safe, convenient, and efficient transportation of people and goods across state highways. It also provides for the safe operation of commercial trucks through inspection at weigh stations, and provides protection for state facilities. The CHP's budget is supported primarily from the Motor Vehicle Account (MVA).

The Budget proposes \$1.3 billion for the CHP in 2004-05, which reflects a decrease of approximately \$14 million over the revised current year, and funds 7,284 officers and 3,267 support staff.

The Budget proposes \$250,000 (Motor Vehicle Account) to study the options for consolidating headquarters personnel in Sacramento from five locations to one.

Department of Justice. The Budget proposes \$621.9 million (\$297 million General Fund and \$324 million in various special funds and reimbursement authority) for the Department of Justice in 2004-05, which reflects a decrease of approximately \$10 million over the revised current year.

The major proposed adjustments are:

- A fund shift of \$3 million in General Fund to the Restitution Fund to continue the California Witness Protection Program.
- An augmentation of \$2.4 million federal trust funds to enhance the California Methamphetamine Strategy Program (CALMS) with electronic surveillance equipment.
- An augmentation of \$671,000 of Indian Gaming Special Distribution Fund authority to make 7.0 expiring positions permanent to address Indian gaming regulatory workload requirements.
- A General Fund unallocated reduction of \$3 million.
- A General Fund decrease of \$1 million and the elimination of 13 vacant positions from the CALMS program.
- A General Fund reduction of \$2.5 million due to the decline in litigation workload related to the *Plata v. Davis* lawsuit.

Youth and Adult Correctional Agency. The Budget proposes an augmentation of \$630,000 General Fund and 6.0 positions associated with the assumption of the duties relating to internal affairs practices of correctional agencies currently provided by of the Office of the Inspector General. This augmentation will be offset by the \$2.7 million General Fund reduction resulting from the elimination of the Office of the Inspector General.

Commission on Peace Officers Standards and Training (POST). The Budget proposes \$54.2 million in special fund and reimbursements (28.2 million state operations and \$25.9 million local assistance) for the Commission in 2004-05, which reflects an increase of approximately \$3.4 million over the revised current year.

Department of Corrections. The Budget proposes \$5.3 billion (\$5.2 billion General Fund and \$128 million in various special funds and reimbursement authority) for the Department of Corrections (CDC) in 2004-05, which reflects a reduction of approximately \$447 million over the revised current year. This consists of an increase of \$413 General Fund, and reductions of \$852 million federal funds and \$8 million in other special funds and reimbursements.

CDC's inmate population is projected to increase from 163,536 on June 30, 2004 to 163,620 by June 30, 2005, an increase of 84 inmates. The parole population is projected to decrease from 112,019 on June 30, 2004 to 110,631 by June 30, 2005, a decrease of 1,388 parolees.

The major proposed adjustments are:

- \$99.5 million General Fund increase and 1,238.8 positions related to adjusting posted position relief factors to the appropriate level and thereby provide adequate resources for CDC to cover posts.
- A "pending unallocated reduction" of \$400 million General Fund for the 2004–05 fiscal year. The Secretary of the Youth and Adult Correctional Agency (YACA) is developing a proposal with the goal of achieving savings totaling \$400 million. According to the Administration, since the majority of these savings will be due to reforms within the CDC, the \$400 million is being reflected as a pending unallocated reduction in the Budget. As part of the May Revision, when the proposal is completed, the actual savings amount will be allocated to the affected departments within YACA.
- A reduction of \$42.9 million General Fund and 418.3 positions pursuant to personnel adjustments required in Control Section 4.10 of the 2003 Budget Act.
- A General Fund reduction and transfer of \$2.6 million from local assistance to the Trial Courts budget in order to comply with a statutory requirement to reimburse trial courts for costs related to hearings or trials for crimes committed in a state prison.

- A reduction of \$852 million federal funds to reflect the one-time only expenditure of funds in 2003-04 provided to California from the federal Jobs and Growth Tax Relief Reconciliation Act of 2003.
- \$18.8 million General Fund for three continuing and four new Capital Outlay projects (\$11 million), statewide minor projects (\$5 million), a statewide evaluation of mental health facilities (\$1.8 million), and studies and budget packages (\$1 million).
- A General Fund augmentation of \$723,000 and 10.6 positions related to increased medical guarding and transportation at Patton State Hospital.
- A General Fund augmentation of \$408,000 and 5.5 positions (one-year limited-term) related to the Health Information Portability and Accountability Act of 1996.
- A General Fund reduction of \$456,000 related to the conversion of 20 Clinical Psychologist positions to Psychology Associates.

Department of the Youth Authority. The Budget proposes \$378.1 million (\$317 million General Fund and \$61 million in various special funds and reimbursement authority) for the Department of the Youth Authority (YA) in 2004-05, which reflects a net decrease of approximately \$57 million, including a General Fund decrease of approximately \$45 million over the revised current year.

YA's youthful offender (ward) population is projected to decrease from 4,055 on June 30, 2004, to 3,820 by June 30, 2005, a decrease of 235 wards. The parole population is projected to decrease from 4,025 on June 30, 2004, to 3,810 by June 30, 2005, a decrease of 215 wards.

The major proposed adjustments include:

- A reduction of \$35.7 million General Fund and \$5.5 million reimbursements, and 319.3 positions associated with the closure of Fred C. Nelles Youth Correctional Facility and one Youth Correctional Conservation Camp.
- A General Fund reduction of \$600,000 associated with a reduced parolee population (reflecting a reduction to the age of Youth Authority jurisdiction for wards), and implementation of a blended jurisdiction model and a casework staffing model.
- A reduction of \$577,000 General Fund (Proposition 98), and 17.0 positions pursuant to personnel adjustments required in Control Section 4.10 of the 2003 Budget Act.
- A reduction of \$2.7 million General Fund (Proposition 98) and 45.3 positions associated with the closure of various YA facilities.
- \$2.8 million General Fund for minor capital outlay and budget packages.

Board of Prison Terms. The Budget proposes \$25.1 million in General Fund for the Board in 2004-05, which reflects an increase of approximately \$238,000 over the revised current year.

The major proposed adjustments include:

- A augmentation of \$238,000 General Fund related to the attorney's fees associated with the *Armstrong v. Davis* federal court case.
- A reduction of \$1.3 million General Fund and 21.5 positions pursuant to personnel adjustments required in Control Section 4.10 of the 2003 Budget Act.

Board of Corrections. The Budget proposes \$75.6 million (\$1.3 million General Fund and \$74.2 million in various special and federal funds, and reimbursement authority) for the Board in 2004-05, which reflects a net reduction of approximately \$52.8 million over the revised current year (\$21.9 million

General Fund reduction, \$32.4 million federal fund reduction, \$1.9 million Board of Corrections Administration Fund increase, and \$102,000 Corrections Training Fund reduction).

The major proposed adjustments are:

- A reduction of \$1.7 million General Fund and increase of \$1.9 million Board of Corrections Administration Fund as a result of the Board being funded through the collection of fees from local governments rather than General Fund. Local entities that wish to continue to benefit from Board activities such as ensuring the establishment of minimum standards for local adult and juvenile detention facilities, including facility inspection, will now be required to pay fees for these and other related services.
- \$36.1 million (\$507,000 General Fund, \$35.6 million federal fund and \$10,000 reimbursement authority) and 10.8 positions to administer and distribute Juvenile Justice Grant funds transferred to the Board due to the elimination of the Office of Criminal Justice Planning.
- A reduction of \$452,000 (\$283,000 General Fund, \$110,000 reimbursement authority, \$31,000 Corrections Training Fund, \$28,000 federal funds) and 6 positions pursuant to personnel adjustments required in Control Section 4.10 of the 2003 Budget Act.

Citizens' Option for Public Safety (COPS) and Juvenile Justice Crime Prevention Act Program (JJCPA). The Budget proposes \$200 million General Fund (\$100 million for COPS and \$100 million for JJCPA). COPS provides funding for front-line local law enforcement to hire and retain additional officers and for prosecuting district attorneys. JJCPA provides funding to operate programs proven to be effective in dealing with at-risk-youth and juvenile offenders that provide for a myriad of responses including intensive case management, early intervention and substance abuse treatment.

Incarceration of Undocumented Felons. The Budget assumes that the state will receive approximately \$66.2 million in federal State Criminal Alien Assistance Program funding for the 2004-05 fiscal year. These federal funds are for the partial reimbursement of the costs associated with the incarceration of the undocumented felon population in prison. The Department of Corrections and the Youth Authority expect to spend approximately \$711.2 million in 2004-05 for the incarceration of undocumented persons.

Local Government Financing. The Budget proposes to eliminate reimbursements to cities and special districts for booking fees which would result in General Fund savings of \$38.2 million in 2004-05. In addition, the Administration indicates that it will be supporting AB 1749 which would eliminate counties' ability to charge booking fees.

Labor and Workforce Development

Department of Industrial Relations. The Budget includes \$289.9 million (\$62.2 million General Fund) for the Department of Industrial Relations.

- **Worker's Compensation.** The worker's compensation system has grown from \$11 billion to \$28 billion in just five years. California's business competitiveness has been severely impacted by high costs, and many employers cite these cost increases as reasons not to expand or relocate in California. A number of worker's compensation cost-containment reforms were implemented January 1, 2004. However, the Administration proposes further reforms that: (1) ensure California's standards are in line with nationally recognized workers' compensation standards; (2) use proven, consistent methods of medical treatment; (3) use nationally recognized and consistent guidelines for individuals with permanent disabilities; and, (4) provide innovative approaches, such as "Direct-

Access to Care” coverage, that maximize the benefits of the group-help model. Any budgetary changes needed as a result of the of the final reform package will be addressed in the 2004 May Revision.

Employment Development Department. The Budget includes \$12.6 billion (\$18.8 million General Fund) for the Employment Development Department to administer the Unemployment Insurance and Disability Insurance programs, administer labor exchange and job training programs, and collect personal income tax from employers.

- **Unemployment Insurance (UI).** Significant fund solvency issues must be resolved that were caused by the recession and past UI benefit and eligibility expansions. UI taxes paid by employers are determined by the fund balance and projected distributions. As listed in Table 4 below, the average UI cost per employee has increased by more than 84 percent in two years (from \$177 to \$326). The Administration requests that stakeholders from both labor and business identify options to reach consensus on this problem. Budgetary changes will be considered for the 2004 May Revision.

Table 4
Unemployment Insurance

Year	Average UI Tax Rate on the First \$7,000 each Worker Earns	Average UI Annual Cost Per Employee
2002	2.53%	\$177.10
2003	3.12%	\$218.40
2004	4.66%	\$326.20
Source: October 2003 Unemployment Insurance Fund Forecast		

Paid Family Leave. The Budget includes \$395.5 million for the first full year of operation of the Paid Family Leave program authorized by recent legislation. Withholdings from employees’ pay began on January 1, 2004 and benefit payments will commence July 1, 2004.

Resources and Environment

Department of Forestry and Fire Protection. The Budget proposes \$634.6 million (all funds) and 5,185 personnel years for 2004-05. The major proposals are:

- Fees are proposed to increase by \$10 million. The current-year budget included a \$10 million General Fund reduction in anticipation of a fee increase for review of timber harvest plans. However, the legislation to implement the fee increase was not enacted, leaving a \$10 million shortfall in the Department’s funding. The Budget proposes legislation to enact the fee and cover the shortfall.
- Forest and other resources management activities are proposed to increase by \$12.3 million (special funds). Activities include vegetation management in order to mitigate fire hazards, regulation of timber harvesting, and operation of demonstration forests.

Parks and Recreation. The Budget proposes \$331 million (all funds) and 2,994 personnel years for 2004-05. The major proposals are:

- Fees are proposed to increase by \$18 million effective July 1, 2004. At the new rates, camping fees will range from \$11 to \$25 and day-use fees are between \$4 and \$14 depending on the location and level of demand. The Administration indicates that this proposal will reduce General

Fund expenditures by \$15 million, and are necessary to maintain park operating hours and access to the public. The Budget enacted in August 2003 increased fees by \$20 million.

- Appropriations of \$41.1 million in special funds have been proposed for local grants, park restoration and infrastructure improvements.

Williamson Act. Administrative functions related to the Williamson Act and the California Farmland Conservancy Program are proposed to be shifted from the General Fund to special funds, for a General Fund savings of \$551,000. Beyond this reduction, the Budget proposes to maintain funding for the Williamson Act.

Local Flood Control Projects. Approximately \$116 million was provided in fiscal year 2003-04 for flood control projects. Local agencies typically pay for the projects up-front and then bill the state. These funds were to be used to repay local agencies for prior project billings, some of which are several years old. However, since current law does not establish a timeframe for repayment, appropriations for flood control are often reverted in years of financial difficulties. As part of the Mid-Year Spending Reduction Proposal, the Budget proposes to revert \$105 million to the General Fund.

All American Canal. The Budget proposes \$16.1 million to fund the lining of the All American Canal, consistent with the implementation of the Colorado River Quantification Settlement Agreement (QSA). This Agreement is a consensus among various local water agencies to reduce the State's use of the Colorado River water.

Conservation Corps. The Budget proposes to reduce General Fund expenditures by \$12.8 million as follows:

- \$10.5 million as a result of closing two residential centers and four non-residential centers, and downsizing two non-residential centers.
- \$2.3 million by eliminating health benefits for corps members. According to the Conservation Corps, their members make infrequent use of health benefits because the majority of them are between the ages of 18 and 23.

Air Resources Board. The Budget proposes increasing stationary source program fees by \$2.6 million and reducing General Fund expenditures by a like amount. The 2003 Budget Act increased these fees by \$14.4 million.

Proposition 50. Approved by the voters in November 2002, Proposition 50 authorizes the state to issue \$3.44 billion in general obligation bonds for water-related programs. The Budget proposes no additional appropriation of Proposition 50 funds at this time. However, the Administration indicates that a proposal will be included in the May Revision.

Energy

The Administration proposes to implement various strategies to reform California's energy situation by stimulating private investment in the energy market, creating a wholesale power market, assuring adequate and diverse fuel supplies for power generation, encouraging energy conservation, and enacting electricity reserve requirements on power generators.

Elimination of the California Power Authority. This agency was established to promote conservation and renewable resources, with the intent that it become financially self-sufficient. The Budget proposes elimination of the agency effective September 30, 2004 because it has not reached financial self-sufficiency and private entities already perform similar activities.

General Government

Statewide Issues

Capital Outlay. The Budget proposes \$1.55 billion in capital outlay expenditures for 2004-05, exclusive of K-12 schools, transportation and state conservancies. Of this amount, \$769.2 million is for the continuing phases of previously approved projects and \$780.8 million is for new projects. Funding for this program comes from multiple fund sources including General Fund, federal funds, bond funds and various special funds.

General Obligation Bonds. California owes \$27.7 billion in principal on outstanding, non-self liquidating general obligation (GO) bonds as of the end of calendar year 2003. The General Fund cost for the payment of interest and redemption on these bonds is \$1.9 billion in 2003-04 and is estimated at \$3.1 billion in 2004-05. This amount could vary depending on the actual amount of bonds sold during the year.

Lease-Revenue Bonds. The state uses lease-revenue bonds to supplement the GO bond program. Outstanding lease-revenue bonds totaled \$6.8 billion as of November 1, 2003, and are estimated to total \$7.4 billion as of June 30, 2004, and \$8 billion as of June 30, 2005. The General Fund cost for lease payments (principal and interest) was \$569.6 million in 2002-03 and is estimated to be \$653.6 million in 2003-04 and \$731.7 million in 2004-05.

State Employer Retirement Contributions. The Budget proposes two strategies to control the state's costs for pension benefits. First, the state will be seeking to increase the employees' annual contribution by one percent of their gross pay rather than change retirement benefits. In most cases this would increase the employee's contribution from five to six percent. Secondly, new employees to state service would receive a less generous retirement benefit package than the one provided to current employees. Until these reforms can be implemented, the state will be seeking new Pension Obligation Bonds (POB) totaling \$929 million to fund a portion of its pension contributions. These reforms are expected to save the General Fund \$4.6 billion over the next 20 years. (The current year POB proposal was merely a method to delay the state's annual contribution, rather than a component of a long-term restructuring of pension benefits as proposed in the 2004-05 Budget.)

Augmentation for Employee Compensation. This Budget reflects funding augmentation amounts for state civil service and related employee compensation. The Budget proposes \$874.5 million (\$464.3 million General Fund) to fund compensation and benefit adjustments for represented employees in the 16 Collective Bargaining Units that have Memoranda of Understanding ratified by the Legislature and as approved by Department of Personnel Administration for excluded employees.

State Teacher's Retirement System. The Budget proposes to increase funding for Benefits Funding by \$21 million General Fund as a result of increased teacher payroll. Additionally, the Budget proposes to increase funding for the Supplemental Benefit Maintenance Account (SBMA) in the State Teacher's Retirement Fund by \$526.1 million: \$26.1 million General Fund as a result of an increase in teacher payroll and \$500 million General Fund to reflect that the \$500 million-reduction in 2003-04 was a one-time only action.

Departmental Issues

Franchise Tax Board. The Franchise Tax Board (FTB) administers the Personal Income Tax and Corporation Tax laws, which consist of self-assessment, filing enforcement, audit and tax collection activities. These activities contribute approximately 60 percent of the General Fund's major tax and

license revenue. The Budget proposes \$560.5 million (\$442 million General Fund and \$118 million in various other special funding sources) for the FTB in 2004-05, which is net increase of \$28 million over the revised current year. Additional proposals in the budget include:

- A redirection of 30 personnel years from their audit program to conduct audits of abusive tax shelters.
- \$1.8 million and 28.1 personnel years to manually review 268,000 personal income tax non-filer accounts.
- \$12.5 General Fund and \$21.3 million in reimbursement authority to continue development of the California Child Support Automation System. This augmentation is primarily for business-partner payments.
- A reduction of \$27 million General Fund and 480 positions pursuant to personnel adjustments required in Control Section 4.10 of the 2003 Budget Act.

Board of Equalization. The Board of Equalization (BOE) administers 23 tax programs, including sales and use tax and the motor vehicle fuel tax. These programs generate approximately 33 percent of the state's revenues. The Budget proposes \$326.8 million (\$194.4 General Fund and \$132.4 million in various other special funds and reimbursement authority) for net reduction of \$1.4 million over the revised current year. Additional proposals in the budget include:

- An augmentation of \$8.2 million Cigarette and Tobacco Products Compliance Fund and 80.7 personnel years to implement, administer and enforce the new Cigarette and Tobacco Products Licensing program under the provisions of Chapter 890, Statutes of 2003.
- An augmentation of \$664,000 in reimbursement authority and 2.1 personnel years to implement and administer the new water rights program under the provisions of Chapter 741, Statutes of 2003.

Military Department. The Budget includes \$93.8 million (\$31 million General Fund and \$62.8 million in various other special funds and reimbursement authority) for a net reduction of \$13 million over the revised current year. Additional proposals in the budget include:

- An augmentation of \$2.1 million reimbursement authority and 7 limited-term personnel years for Homeland Security equipment, training, exercises and infrastructure.
- An augmentation of \$383,000 federal funds and 4.7 personnel years to support fire-fighting activities at the Fresno Air National Guard Base.
- An increase of \$360,000 federal funds and 4.7 personnel years to support the Military Construction and Armory Maintenance programs.
- An augmentation of \$133,000 federal funds and 0.9 personnel year to operate the Joint Training and Experimentation Program.
- An increase of \$129,000 federal funds and 0.9 personnel year to support the Operation Ready Families Program.
- A reduction of \$1.4 million General Fund and 10 personnel years associated with reductions to the Starbase Program, Challenge Program and California Cadet Corps.
- \$12.3 million (\$5 million General Fund and \$7.3 million federal fund) to complete the construction of a new armory in Bakersfield in order to accommodate two new transportation units assigned to the area.

Department of General Services. The Budget includes \$875.9 million (\$3 million General Fund and \$872 million from various other special funding sources) for a net increase of \$21 million over the revised current year.

Department of Financial Institutions. The Budget proposes \$23.6 million special funds for a net increase over the revised current year of \$2.1 million. This includes an augmentation of \$2.4 million and 17 positions to implement the provisions within Chapter 241, Statutes of 2003, California Financial Information Privacy Act.

Department of Corporations. The Budget proposes \$29 million State Corporations Fund in 2004-05 for a \$2.5 million increase over the revised current year. Additional proposals in the budget include:

- \$1.2 million State Corporations Fund and 13.6 positions to address workload resulting from Chapter 241, Statutes of 2003, California Financial Information Privacy Act, as it relates to the regulation of Broker Dealers and Investment Advisers.
- \$756,000 State Corporations Fund and 8.4 positions to address workload resulting from Chapter 241, Statutes of 2003, California Financial Information Privacy Act, as it relates to the regulation of California Finance Lenders and Mortgage Bankers.
- \$777,000 State Corporations Fund and reinstatement of 12 positions to address provisions of Chapter 777, Statutes of 2002, Deferred Deposit Transaction Law.

Department of Housing and Community Development . The Budget proposes \$615 million (\$14.2 million General Fund and \$600 million in various other special funds) for a net reduction of \$154 million over the revised current year. The Budget proposes the reduction of \$280,000 General Fund from the Office of Migrant Services Program to reflect the full-year savings from the closure of one state-owned migrant center.

Stephen P. Teale Data Center. The Budget proposes \$95.7 million Stephen P. Teale Data Center Revolving Fund for net reduction of \$2.5 million over the revised current year. Pursuant to Chapter 225, Statutes of 2003, the Administration is considering a reorganization plan to consolidate the Teale Data Center with the Health and Human Services Data Center effective in 2004-05.

Department of Personnel Administration. The Budget proposes \$56.7 million (\$26.3 General Fund and \$30.4 million in various special funds and reimbursement authority), which is a \$19.4-million reduction over the revised current year.

State Personnel Board. The Budget proposes \$17.1 million (\$3.3 million General Fund) a reduction of \$747,000 over the revised current year.

California Victim Compensation and Government Claims Board (Board). The Board's primary role is to compensate victims of violent crime for certain crime-related financial costs. Compensation for the victims comes primarily from the Restitution Fund; and, the two major sources of revenue to the Restitution Fund are penalties on felony convictions and federal funds. The Budget proposes \$141.3 million in 2004-05 – an increase of \$2.8 million over the revised current year. The Budget proposes to shift costs associated with the Government Claims Program to reimbursements, for General Fund savings of \$809,000 beginning in 2004-05. Under this proposal, filers of civil claims against the state would pay a filing fee, which would be refunded upon approval and payment of the claim. Included within this reduction plan is a proposal to require charities that participate in the California State Employees Charitable Campaign to support the full cost of the certification program. To date, the General Fund has supported these costs.

Commission on State Mandates. The Budget proposes to suspend or repeal various non-Proposition 98 mandates resulting in an annual cost avoidance of \$264 million.

California's Fair Share of Federal Funds. The non-partisan California Institute for Federal Policy Research estimates that payments made by California taxpayers to the federal Government significantly exceeded the amount of federal expenditures in the state by as much as \$58 billion in federal fiscal year 2002. In efforts to mitigate this ongoing inequity, the Administration indicates that it will work with California's Congressional Delegation to increase the state's share of federal funding. The Budget assumes that the state will be able to secure a minimum of \$350 million to offset General Fund expenditures related to items such as Homeland Security, Transportation, Medi-Cal, Incarceration of Undocumented Felons, Child Care Funding and Education Tax Credit eligibility.

Department of Veteran's Affairs. The Budget includes \$293.7 million (\$61.2 million General Fund) to provide services to California veterans and their dependents. This funding level represents a decrease of \$10.4 million (\$3.9 million General Fund) from 2003-04. General Fund funding for this department has increased by 55 percent from 1998-99 to 2003-04.

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